

PREFATORY NOTE

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Meeting of the Federal Open Market Committee

March 26, 1985

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Monday, March 26, 1985 at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Balles
Mr. Black
Mr. Forrestal
Mr. Gramley
Mr. Keehn
Mr. Martin
Mr. Partee
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Boykin, Guffey, Mrs. Horn, and Mr. Morris, Alternate Members of the Federal Open Market Committee

Messrs. Boehne and Stern, Presidents of the Federal Reserve Banks of Philadelphia and Minneapolis, respectively

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, 1/ General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Bisignano, Broaddus, R. Davis, Kohn, Lindsey, Prell, Scheld, Siegman, and Ms. Tshinkel
Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Cross, Manager for Foreign Operations, System Open Market Account

1/ Entered meeting after action to ratify transactions in domestic operations.

Mr. Coyne, Assistant to the Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mrs. Low, Open Market Secretariat Assistant,
Board of Governors

Messrs. Garbarini and Hendricks, First Vice Presidents,
Federal Reserve Banks of St. Louis and Cleveland,
respectively

Messrs. Balbach, Burns, T. Davis, and Lang, Senior Vice
Presidents, Federal Reserve Banks of St. Louis,
Dallas, Kansas City, and Philadelphia, respectively

Messrs. McNees, Meek, and Rolnick, Vice Presidents,
Federal Reserve Banks of Boston, New York, and
Minneapolis, respectively

1/ Mr. Timlen, out of the country at this time, executed his oath of office
on April 1, 1985.

Transcript of Federal Open Market Committee Meeting of
March 26, 1985

MR. MARTIN. With the indulgence of the Federal Open Market Committee, I would like to nominate Paul Adolph Volcker as the Chairman of the Federal Open Market Committee.

CHAIRMAN VOLCKER. Nominations closed!

MR. GRAMLEY. Did he call him P. Adolph Volcker?

CHAIRMAN VOLCKER. None of that!

MR. MARTIN. With the concurrence of the new Chairman, I would like to nominate Gerald Corrigan as the Vice Chairman of the Federal Open Market Committee.

CHAIRMAN VOLCKER. Are there any objections? I'm not hearing any. We will proceed to the selection of staff officers. Maybe the Secretary can read the roll of proposed staff officers.

MR. BERNARD.

For Staff Director and Secretary, Stephen Axilrod
Assistant Secretary, Normand Bernard
Deputy Assistant Secretary, Nancy Steele
General Counsel, Michael Bradfield
Deputy General Counsel, James Oltman
Economist, James Kichline
Economist (International), Edwin Truman.

Associate Economists from the Board:

Donald L. Kohn;
David E. Lindsey;
Michael J. Prell; and
Charles J. Siegman.

Associate Economists from the Federal Reserve Banks:

Joseph R. Bisignano, proposed by President Balles;
J. Alfred Broadus, proposed by President Black;
Richard Davis, proposed by President Corrigan;
Karl Scheld, proposed by President Keehn; and
Sheila Tschinkel, proposed by President Forrestal.

SPEAKER(?). So moved.

MR. MARTIN. Second.

CHAIRMAN VOLCKER. Without objection. We need to select the Federal Reserve Bank for the execution of transactions for the System Account. The New York Bank has performed this service for some years. Do we have a motion?

MR. MARTIN. Move the New York Bank.

CHAIRMAN VOLCKER. We need a second.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. We need to select the Managers for Domestic and for Foreign Operations of the System Open Market Account. Do I have a nomination for Mr. Sternlight and Mr. Cross?

MR. MARTIN. So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. You presumably have reviewed the current Foreign Currency Authorization, the Foreign Currency Directive, and the Procedural Instructions with respect to Foreign Currency Operations. There are no changes [proposed] in any of these. Are there any objections to continuing those? In the absence of any objections we will proceed.

In the Authorization for Domestic Open Market Operations, we have a proposal to change the intermeeting limit. Mr. Sternlight, do you want to speak to that?

MR. STERNLIGHT. Mr. Chairman, I don't think I have anything significant to add to the short memorandum that I sent to the Committee on that subject. As noted there, we had half a dozen occasions last year when we asked for increases in the intermeeting limit. It was never a problem to get [the Committee's approval of] those increases, but since we asked for increases in fully half of the intermeeting periods I think it was becoming almost a routine matter that was going beyond the purpose served by that intermeeting limit. That purpose, it seems to me, is to flag really unusual changes. If the limit were put up to a \$6 billion level, I think it would still serve that purpose of flagging unusual changes in that leeway. I might mention that in the period that is coming up now we may very possibly need an increase even beyond the \$6 billion. But I would rather wait until we are further into the period and have a better idea of just how much of a temporary increase we may want to request.

CHAIRMAN VOLCKER. Any discussion?

MR. KEEHN. Not on that point. But with regard to the holdings, I would like to raise a question with regard to Farm Credit Bank holdings in the System Account. Given the circumstances, I wonder whether it would be appropriate to add to those holdings during the current year.

CHAIRMAN VOLCKER. Let's dispose of this limit first. I take the silence to mean acquiescence. We had better get a motion then.

VICE CHAIRMAN CORRIGAN. Move it.

MR. MARTIN. Second.

CHAIRMAN VOLCKER. With no objection, it's approved. Maybe we can wait [on the issued raised by Mr. Keehn] until we get to the agenda item on domestic open market operations. We need to approve the minutes.

VICE CHAIRMAN CORRIGAN. So moved.

MR. MARTIN. Second.

CHAIRMAN VOLCKER. Without objection. Mr. Cross.

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN VOLCKER. All in all not much of a market.

MR. PARTEE. No question; the quality of it isn't much.

MR. RICE. Why did we buy sterling? Even though it was a small amount, what were the reasons for that?

MR. CROSS. Well, this was at a time when sterling was being particularly hard hit and our purchase was in part a cooperative gesture to the British, who were very much concerned that the pound was taking more than its share of the brunt of this change. It coincided with the time of the high level visit of Mrs. Thatcher.

MR. RICE. It was really just a gesture?

MR. CROSS. Well, I think it had some implications of being done in light of those political circumstances, yes.

MR. WALLICH. Sam, \$10 billion is a large amount even relative to the U.S. current account deficit. Do you see this amount of dollars having been put into the market as having any lasting effect on the exchange rate or is the whole move of the dollar due to [the savings and loan situation in] Ohio and similar factors?

MR. CROSS. I would certainly think that the intervention had its effect. We collectively--mainly other central banks--added really quite an enormous amount of dollars to the stocks sitting out there. If you consider that we're running about a \$10 billion current account deficit every month, we added another month there; and somebody has to absorb those dollars. Some of those were absorbed at levels that now don't look very good. So that has been overhanging the market and [the intervention] has called attention to the fact that the authorities can come in with a pretty heavy hand and do these operations. This is undoubtedly part of the reason, but not the only reason, why the markets themselves are in such a sloppy condition. People are increasingly unwilling to be market makers out there. I think intervention certainly has had an effect. It has reminded the market that the officials can come in rather forcefully and it has left a lot of dollars out there to be absorbed.

CHAIRMAN VOLCKER. I'm not sure everybody interprets intervention as having that large an effect.

MR. PARTEE. It's the equivalent of a month's current account deficit. It seems to me the price effect was quite small for that kind of quantity.

MR. CROSS. Well, \$10 billion is small relative to the total of \$120 billion. Still, it's money that somebody out there has--

MR. PARTEE. I understand. They have to hold it.

VICE CHAIRMAN CORRIGAN. I think you have to look at the foreign exchange market right now in broader terms than just the dollars representing the current account deficit. The magnitude of traffic in the churning and trading that are taking place in that market--both in the cash market and all these derivative markets--is just mind boggling at this point. I don't know how to measure it, but my hunch is that if we measured this particular episode of intervention against the size of the market in a trading sense--the \$10 billion dollars spent over this period relative to what \$10 billion dollars would have been in, say, 1978--my hunch is that it would be a pittance. Now, ultimately, the stocks should have something to do with the price response. But that market is just so enormous. Frankly, it's so enormous that to me it's very troubling just by nature of the flows and the changing structure and character. Sam and I were talking a little about that at breakfast this morning.

MR. PARTEE. In terms of total stocks of financial assets the addition of \$10 billion wouldn't be large; it would be very small.

CHAIRMAN VOLCKER. We have to ratify the transactions.

MR. MARTIN. Move it.

CHAIRMAN VOLCKER. Without objection. Mr. Sternlight.

MR. STERNLIGHT. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Are there any comments on this general subject matter before we get to [the issued raised by] Mr. Keehn?

MR. RICE. Peter, how do you explain the fact that the ESM debacle had less effect on the market than Drysdale even though it would seem that the ESM effects will have wider ramifications?

MR. STERNLIGHT. I think what was so frightening in the Drysdale case, Governor, was that there were a number of dealers that were heavily involved. And until Chase Manhattan and Manufacturers Hanover came through and agreed to meet those interest payments that Drysdale was unable to make on that fateful day, there were a number of dealers who were threatened with very serious losses and there was a real question of the ability of these major market makers to function in the market. The market was on the edge of becoming rather seized up and just unable to function well. This time there was a kind of disgust, a view that another one of these small dealers has misbehaved and inflicted some losses in various places in the economy. But this was not seen as entering the central marketplace in the same way as Drysdale.

MR. PARTEE. It was just the public that lost.

MR. RICE. Right. Only one dealer was involved.

MR. GRAMLEY. They worry about their own.

VICE CHAIRMAN CORRIGAN. There were a couple of dealers involved, but they were able--

MR. STERNLIGHT. There were some that took losses, too, but they were rather modest--certainly modest against their own capital strength.

MR. PARTEE. What about the implications for this clearing agent? I guess they were going out of the business anyway? Is that right?

MR. STERNLIGHT. Yes. The firm that was doing the clearing for them was already in the process of unwinding its clearing operations.

CHAIRMAN VOLCKER. If there are no other matters to raise for Mr. Sternlight, we'll turn to Mr. Keehn.

MR. KEEHN. I would just like to raise a question--not on the current holdings of Farm Credit Bank bonds--but whether adding to those holdings is appropriate. I don't know what the credit status of those bonds is but everything I hear leads me to believe that there are some questions about it. It is conceivable that we might get into a position later on where we will have to be financing that and we could be in the awkward position of holding the bonds and having added to the bond holdings during the year and at the same time we would be financing it. I just raise the question as to whether this is appropriate.

CHAIRMAN VOLCKER. The quid pro quo of your comment is that it is not appropriate?

MR. KEEHN. I would think that if there is any substantial question about the credit standing of the Farm Credit Banks, maybe it would be appropriate not to be adding to those holdings.

CHAIRMAN VOLCKER. We haven't added for some time, have we?

MR. STERNLIGHT. We have rolled over maturing holdings of agency issues but we have not added to holdings of agency issues for a couple of years now, Mr. Chairman. We have been watching the spreads in the agency market because we were concerned about just these kinds of questions. And in the eyes of the market--although we hear of an occasional case where an investor or two wants to reduce its exposure there--in general those spreads are holding quite narrowly for Farm Credit [issues] and for [those of] the other agencies too. In fact, one could probably raise questions about all of those agency securities--those of the Home Loan Banks or of Fannie Mae, which have had some loss experience. But in general those spreads are holding up very well and the Farm Credit Banks have been putting on a strong, and to me a fairly convincing campaign, to the effect that the system as a whole has quite a lot of strength in it. There was one Intermediate Credit Bank in Spokane that needed help from the rest of the system but in general they present what seems to the market--and to me in what I've seen--a fairly good picture.

MR. GRAMLEY. Do we have any maturing Farm Credit issues coming due in the near future?

MR. STERNLIGHT. Yes.

MR. GRAMLEY. That, I suppose, would be the critical issue that we face.

MR. STERNLIGHT. We typically roll over the maturing ones into similar amounts.

MR. GRAMLEY. What do we have in the near term in that respect?

MR. STERNLIGHT. I don't have a figure in my head.

CHAIRMAN VOLCKER. I don't see how we can't roll over the ones we have.

MR. GRAMLEY. I don't either.

MR. PARTEE. That would show up, wouldn't it?

MR. STERNLIGHT. I think very [unintelligible] in the market. I think it would tend to detract from the--

MR. PARTEE. I certainly agree with Peter that the other agencies seem to me at least as weak, if not weaker, than the Farm Credit Banks. Maybe I think that because they do have a very strong capital position. It's true that they have the largest concentration of loans of a potentially bad quality of anybody in the country, but they have very good capital.

MR. MARTIN. It's debatable.

MR. PARTEE. So, it seems to me that we shouldn't do anything that would create a backing away, Si, although I don't think I would buy any more.

CHAIRMAN VOLCKER. There is more than the occasional investor not buying these things. Every country banker you talk to says he is kicking them out. In total they're not big enough to affect the market. I think these agencies are anomalous institutions anyway, and I would just as soon we didn't hold any or buy any. But we have a history [of doing so]. My own feeling is similar to what Mr. Keehn has expressed: We would be in an awkward position if we ended up lending to them and buying [their obligations] in the open market at the same time. If, say, we buy them now, that could be interpreted as support in a way that may or may not be desirable. I think we have to support them if they get in trouble; but I'm not sure we should be treating their securities as the equivalent of government securities, which is what they would like us to do and which we did for awhile--still do, I guess, in some sense. Anyway, I guess we are doing what you are suggesting, Mr. Keehn.

MR. PARTEE. That is, we avoid buying net new issues.

MR. KEEHN. Well, I think the attitude [should be] to try to reduce gradually our holdings without creating any tremor in the market.

CHAIRMAN VOLCKER. I don't think we can reduce them in this particular year.

MR. KEEHN. I don't mean by selling. But where it is possible without creating any market image problems, that seems to me appropriate.

MR. GUFFEY. I, on the other hand, wouldn't view that as being an appropriate role. I think we should stay with them and even at times support them. We're going to support them if they go down anyway. Although I wouldn't make an overt market entry. I'd sure hate to back away from them at this point. I think the statement by Peter that they show a good market presence and that they are able to attract funds at good rates now may be more PR than it is real. And I would hate for us to be a disruptive force by backing away from them.

CHAIRMAN VOLCKER. I don't see how we can back away.

MR. PARTEE. Their total debt has been declining sharply. It has been rather fortunate that their debt has been running off as potential buyers have run off also. It could be a fairly delicate situation.

CHAIRMAN VOLCKER. I'm not sure it's running off all that much; some of that is seasonal.

MR. PARTEE. Well, but it was a billion dollars.

MR. STERNLIGHT. It's about flat. There might have been a modest decline, but I don't think it was a big decline. They certainly have not been net money raisers.

CHAIRMAN VOLCKER. They were anticipating having to raise money from about now on, if I remember correctly. They had a flat period or a slight decline that would be natural but it would go up seasonally. Well, we have to ratify the transactions. [Approved without objection.] Mr. Kichline.

MR. KICHLINE. [Statement--see Appendix.]

MR. AXILROD. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Well, it all sounded rather complicated. I'm not sure of the message that emerged, but I'm sure that we are in a situation without any precedent in our lifetimes in many respects. There is instability in exchange rates and domestic financial markets, a very high dollar, an enormous budget deficit, and an enormous and growing trade deficit. Services are doing fine and the rest of the economy is not doing so well. What do you make out of it?

MR. RICE. Well, I thought the message was clearer than usual from Mr. Axilrod.

MR. GRAMLEY. I thought Mr. Axilrod's message was that there is no way to get there from here.

CHAIRMAN VOLCKER. Without concentrating on the precise growth paths and the precise monetary policy decision, how do you assess the situation generally in the economy and financial markets, and what are the broad implications?

MR. WALLICH. I find somewhat deplorable the way in which the latest number always dominates the year's forecast. Earlier in the year there was a widespread upgrading of projections for the year. Now we've had a month of relatively weak numbers and everybody is backtracking. I think one has to expect that with a moderate rate of growth the numbers will not always be strongly in one direction or the other and perhaps restrain one's eagerness always to take the latest numbers into account. I'm speaking to market forecasters. I would be willing to say we have made what seems to be a reasonable projection. Until there is pretty clear evidence that it is going off track we ought to stick by that and not follow the monthly ups and downs.

MR. MARTIN. But, Henry, I would suggest to you that it isn't just a monthly up and down. In the Greenbook, the staff has revised downward the first-quarter data and has revised downward certain other data that apply to periods of more than a month. They are looking at a 3.3 percent real growth number, which is down something like 10 percent. Certainly, the caveats are more imbedded in the material that is being reviewed than was true in February. We have just heard caveats with regard to business fixed investment. I would agree with those and add the comment, for whatever it's worth, that if I today still had the responsibility for Homart Development Co., I would not be starting one office building, one shopping center of any size, or one multiple unit dwelling in the United States of America. If you look at the curve of the starts in that area, it suggests something that is headed for explosion--an explosion downward. Okay, an implosion. That curve is just unsustainable in that part of the investment area broadly defined. We have seen since mid-1984 a decline in orders in category after category of business fixed investments. It's not just technology and it's not just heavy industry; it's virtually across the board. And it seems to me that a 6 percent growth in business fixed investment, broadly defined, for 1985 is just getting to be a less and less probable event.

I would add to that the fragilities that were alluded to. If you pick up The Wall Street Journal this morning, there is a story about a major Canadian bank. Are we going to go a month without a large financial institution surprising the markets? Are we going to go two or three weeks without or some bank coming up with another \$70 million loss in Paraguay or Ecuador or somewhere? This drumbeat of negative news is having its effect, if you can believe the part of the surveys of consumer attitudes toward financial institutions and finance. It seems to me that we have a very slow--not a moderate--growth, a very fragile financial system, and a very dubious [outlook for] business fixed investment, housing, and non-residential investment. We are looking at a very vulnerable year.

CHAIRMAN VOLCKER. Let me make a few comments, partly reinforced by going to a few board of directors meetings of various Federal Reserve Banks recently and hearing businessmen from the industrial sector of the economy talking. I think there are quite different trends in the industrial sector and elsewhere in the economy. But I don't think there is any doubt that the present trade picture and the prospects for the trade picture are having effects. The question is whether it is cutting the legs off of any expansion in that area or worse. We have seen the analysis. We have seen the event in the past couple of years where a lot of domestic demand has gone abroad, perhaps most strikingly in the area of investment goods.

I think the question now--and the answer is not fully ascertainable but there are some symptoms--is whether the level of the dollar and the competitiveness of foreign goods are cutting investment expenditures--not just the supply of investment spending but the willingness to invest at all. Well, I mean "at all" as a relative term; let me say "at anything like the momentum that it had before." We have had a long series of production and orders figures that, with the exception of February which had some recovery, have been pretty flat. I don't have the sense, and computer manufacturers don't seem to have the sense, that there is any great thrust anymore in that area of the economy that had been the strongest. Now, that may be partly because supply conditions have increased but the indications are for less robustness there. And, of course, in many other areas of heavier equipment there wasn't much recovery at all anyway. In the commercial construction area that Governor Martin alluded to, the current figures are still going up strongly but it's hard to believe that they are going to go up indefinitely. New single-family housing is doing all right and could continue to do all right; I don't know how much of an expansionary force it is going to be. The mining and energy areas don't seem to be going anyplace, to put it kindly. I don't think the farmers are going to be a great source of expansionary thrust in the economy in terms of what they buy. So that's just reinforcing all the questions that already have been cited on the investment side.

In the meanwhile, consumption so far is doing all right and service spending, of course, goes on. I might mention automobiles, which are doing just fine, but I don't know whether there are any prospects for any increases there partly because if the demand increased, I don't think the manufacturers--many of whom are more [unintelligible]--want to either increase capacity or employment in that industry. They have gone about as far they are going to go. If there are going to be any more cars sold, my sense is that they are going to be imported. So, while that's been a good area, it's not an area of great upward thrust. I can't avoid having the feeling that the kind of forecast the staff has may be as reasonable as other forecasts, as we always say, but it looks to me like something within the limits of a ceiling. It's hard to see where we can get more thrust out of the economy than they are projecting and I can see conditions arising, particularly on the import side, that might undercut the kind of forecast they have.

On the inflation side, I think we also have a two-sided situation. On the services side, prices tend to go up with some momentum, and I'm not sure that's going to change. I'm sure it's not going to change much in the short run; it may be getting a little better but it's not suddenly going to turn toward stability. Prices on the goods side of the economy are basically flat. So, it's a little hard to see in these circumstances--and I'm assuming no major changes in monetary policy, fiscal policy, the dollar, and foreign developments--any great break-out there. Of course, we have the background of the financial strains that have been mentioned. I'll at least stop there and you can all shoot at that analysis. Mr. Boehne.

MR. BOEHNE. One of the frustrating things about the economy is that it's so hard just to grab a simple summary of what it is that is going on. I think that already has been made clear in this discussion. There is just so much variability; there is just no national statement one could make about whether things are good or

whether things are bad. Just to add to the complexity, I sense that in my District--which I suppose for 15 years or so has been more or less a laggard in the economy--some of this prosperity that has been in New England is beginning to drop down into the Mid-Atlantic states. So, we seem to be shifting our position among regions in the national economy. One just senses that things are probably a little better on average in the Middle Atlantic states than they are in some other parts of the country. But even within that relatively small area there are some real pockets of depression and unemployment in industry. If you look at agriculture, Si and Roger probably will continue to talk about the serious problems there; yet if you talk to farmers in Pennsylvania or in Delaware, they generally feel pretty good about the situation, and they are in considerably better shape than farmers elsewhere. So, it's this variability that I think is so frustrating. One isn't able to get a good handle on what is going on in any satisfying sense, and I think that variability causes a great deal of vulnerability in some particular areas.

Let me just add a couple of points about imports. I am finding that [issue raised] at every meeting I attend--in small towns and big cities, with people in small business and big business. This import problem is quickly becoming much more of a political problem than an economic problem. Some of the Congressmen in my area, whom I've seen recently and who understand all the problems of trade restraint and all the good economic reasons why you don't want to do that, tell me that the political pressure is just getting so great they are not sure that they can resist doing something that they know isn't a very good idea. I think that is an indication of how widespread this is.

The financial fragility issue, I think, is a rather interesting one. We are very close in Pennsylvania to Ohio. There was not any noticeable spillover, although it did raise consumer anxiety. Our institutions received lots of telephone calls but no real withdrawals occurred. But I think there is a difference. I think because of Ohio the financial fragility is more serious now than it was three weeks ago because the ordinary person understands it more. The ordinary person doesn't really understand government securities markets or international debt problems, but he does understand lines and the concern that he can't get his money out. So I think there is a new dimension to this fragility.

Having made those observations, my general sense is that the economy is growing. I don't think that we're going to have a recession; I think it is growing. I do not sense any inflationary problems or any increase in inflation. So, without getting very specific about monetary policy, it seems to me that this is a good time not to do anything--just to stay where we are and not rock the boat from this quarter.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, it seems to me that the Greenbook projections for the first quarter and also for the rest of the year are pretty reasonable. I think, as Henry Wallich stated, that there is a tendency on our part to look at the most recent news in particular, and I think people have been focusing on the flash report for GNP. But if you look behind that and see that the survey on

employment was taken during a bad week, it suggests that employment is probably a little stronger than the figures showed. As you mentioned, the consumer seems to be fairly strong and is spending with confidence, so that looks fairly good. So all in all, it looks to me like a pretty darn good performance for this stage of a business cycle; and it would be particularly good if we can count on inflation staying down.

To me the policy implications stemming from that are that we ought to continue the same sort of policy we have been following the last several years. I wouldn't claim that the entire favorable outcome in the economy generally has been due solely to [monetary] policy, but I think it has done an awful lot to overcome the negative effects of the federal deficit on business confidence and the financial markets. And it probably also has helped to hold down inflationary pressures, although I think it is always important to keep in mind that a 4 percent inflation rate--or whatever the real rate is--is not really success over inflation in any sense. So, with that relatively optimistic view in mind, in relation to what some of the others have said around this table, I think a high priority ought to be given to trying to maintain the same sort of policy we've been following in the past. I would be very concerned if M1 were to move up above the upper band--not just out of the cone but above the upper band--or if we were to target something above that. I would be willing to tolerate a little less accommodative policy if necessary. I think the strength in the dollar is more or less preordained by the fiscal situation; if we try to resist that very much, we may find ourselves unleashing inflation a little more. So, I guess I'm considerably more hawkish than most of the people who have spoken thus far.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, like some of the others, I think the financial fragility is the new and potentially disruptive development that we're having in the economy. The Ohio situation, of course, did get a lot of national publicity--far more than Mississippi did eight years ago. That indicates something of the kind of concerns that people could have, but it's not the only thing. At our last meeting we were very much steeped and involved in the question of agricultural finance. Now, I don't think that has improved any in this period of time; it's just that Ohio took precedence over it and got more attention. The general savings and loan situation is pretty weak, as we all know, and the Home Loan Bank Board has been working hard to try to cut back on some of the lending that is totally unwarranted that has been done there. We're still subject to accidents, and not just like ESM. I noticed, Bob, that the strongest Texas bank reported in the last couple of days a surprising loss in loans to its directors; and it's just [without] question about the best of the Texas banks. Of course, is probably accident prone, and who knows what the next thing might be that will affect them. My view of the matter is that this probably will be affecting both peoples' attitudes toward the stability of finance and also the attitudes of lenders toward what their posture ought to be. I don't think it's at all a secret that the Comptroller of the Currency is taking a much tougher view in examinations now; he is classifying a lot more loans. And the national banks have a lot of exposure out there now that they didn't have a couple of years ago. I think that affects their attitudes and

the Home Loan Bank Board is affecting S&L attitudes. So, both on the lending side--the availability of credit, which is something that Steve mentioned--and in terms of public attitudes, we have a new risk that I think has grown with the passage of time. And that probably will be reflected by a change in liquidity preferences. There is a little of that apparently in the market with Ohio but it could become very much stronger at some point in the future. I think it makes less dependable--not that they are dependable ever--but less dependable than usual the observation of the monetary numbers, because we don't know what kinds of attitudinal changes might be reflected in those numbers now or in the period ahead. I don't disagree with the staff forecast as a normative forecast. But I do think that the risks, stemming largely from the financial side, are on the down side.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. I think Henry's point about looking over a longer period and not judging where the economy is going by last month's statistics is one that is worth repeating. If one looks at the first-quarter flash [for GNP] and compares it with where we are in the second quarter--during which time we have had a lot of erratic numbers--we're looking at growth of aggregate demand of around 3-3/4 percent and the growth of GNP is between 2-1/2 and 2-3/4 percent because we had a big drop in net exports during this period. What the staff is forecasting basically for the next 3 quarters is a continuation of that very moderate pace of growth in aggregate demand, a little under 4 percent, and a somewhat better GNP performance of about 1/2 percentage point less than the growth of aggregate demand because net exports are not going to drop so much. And that seems to me a reasonable forecast for the moment. I certainly agree that this confidence factor is one that's difficult to appraise, but presumably the staff thought about this in the process of putting together its forecast. I would remind you all that the increase in business fixed investment that they are talking about is a very, very substantial slowdown from what we saw in the first two years of recovery. In the first two years of recovery we have seen an increase in real business fixed investment of over 30 percent--a tremendous increase. And part of this forecast is a consequence, I think, of the erosion of confidence that has occurred. If you ask yourself what has happened typically in the third year of recovery in business fixed investment, typically it continues to go up and it does so even though corporate profits flatten out. The big difference besides the confidence factor this time is the fact that we have been looking at an actual decline in the rate of capacity utilization in manufacturing since the middle of last year. I would be inclined to give that some weight, but not an undue weight, because this is a recovery--as I would appraise it at least--in which the growth of business fixed investment by and large has not been related in any close way to the need for additional capacity. It has been replacement investment; it has been investment designed to cut costs and improve productivity; it has been investment driven very heavily by tax incentives and by technology. Having said all that, I would still come out--although I am a little less gloomy than the Chairman is--with the view that this is a forecast for which the risks are predominately on the down side. I don't see any serious concern that we're going to have more growth of aggregate demand during the course of 1985 and early 1986 than we would want.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Well, Mr. Chairman, I find myself pretty much in agreement with many of the things that you pointed to, though I don't know if I would describe that as excessively gloomy. It depends upon the point of view from which you look at these things. There is a point that you made, which Lyle also pointed out, that I'd like to emphasize, and that is that the staff forecast is probably the best we can hope for. The risks to the forecast seem to me to be on the down side. Looking at the economy, it is very hard to see where a kick to the growth could occur. All the factors pointed to by the Chairman suggest that any higher growth rate than the one projected by the staff just seems to be unlikely. Now having said that, I do think the staff forecast for the short run is a good one. I think the current rate of expansion is probably a comfortable one but there are these vulnerabilities that Pres pointed to. Although the Chairman pointed out that consumer expenditures are really the main source of strength in the economy, it seems to me that as we go out into the year--into the second half--that there is some risk that consumer spending may not hold up. While as of now it seems possible to maintain current rates of growth, declining over time, I wouldn't be surprised at all if in fact the result of these vulnerabilities coming from declines of investment and also the lagged effect of import [penetration] on activity in the economy all add up to much lower rates of growth toward the end of the year than we expect at the present time. Just to summarize, I would say that while the staff forecast seems to me at this time to be the most likely outcome, we have to be prepared to see significantly lower rates of growth than forecast.

As far as the fragility of the financial system, I was much more worried about that a week ago than I am today. I'm encouraged by the way the market has accepted the developments in Ohio and I'm encouraged by the way the people in Ohio have accepted what's going on there. So I'm not as worried as I might have been. While there are these threats to confidence, I would not at this point allow my concern about fragility in the system to influence my monetary policy prescription.

CHAIRMAN VOLCKER. Mr. Stern has a special burden to say something fresh and insightful!

MR. STERN. I don't know if that's good or bad! I don't think there is any doubt that we have a two-tiered economy or whatever you want to call it. In our District, probably the best way to put it is an urban versus a rural split. The urban economies generally are doing rather well. The rural economies, because of agriculture and mining and some problems in timber, are not doing well and, obviously, that's where the fragility is.

Looking at the aggregate picture, though, I must say that with the exception of the February employment and hours statistics in manufacturing I thought the statistics were reasonably positive in terms of retail sales, housing, and continuing increases in commercial construction and so forth. And with that interpretation, I'm not inclined at this point to change my view of the outlook for the balance of the year very much. I continue to think that the economy probably will do somewhat better than the Greenbook forecast. I admit that, yes, there are a lot of uncertainties. But if I were to look at it sector by sector, I would come out with a sense that the interest-sensitive sectors might do a little better than the Greenbook

suggests. I would simply note that nominal interest rates today--real rates, of course, are difficult to gauge--are anywhere from a point and half to three points below their peaks of last year, and of course the economy did well last year. So, one should take that into [account in formulating] monetary policy in general. I agree that there are a lot of things that we have to be sensitive to in terms of domestic and international market factors and problems in specific institutions and in specific sectors of the economy. But I'm a little concerned; we don't want to tolerate excessive expansion in money--probably under any circumstances--but as an antidote to some of those things.

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Well, Mr. Chairman, I'll start with my own District. I think what I'm seeing and hearing is relatively strong growth on average, although there are some weak spots both geographically and in various sectors of that economy. But I'm hearing a lot of confidence even in those areas where economic performance hasn't been all that strong. There has been no spillover at all from the ESM or the Ohio thrift situations that I can tell. We have had some panicky questions from old ladies who had money in Florida thrifts, but there was no run on any of those institutions and no problems.

As I looked at the national economy, I was somewhat surprised by the lower growth rate of GNP--the 2.1 percent flash that came out. But, given the weather situation in February and some other factors, my hunch is that that might be revised up somewhat. I was more concerned, frankly, about the flash number for the deflator, at 5.4 percent. I don't know whether the staff considers that to be a fluke or whether it represents a bottoming out of inflation.

CHAIRMAN VOLCKER. That is an artificial statistic that is virtually meaningless--not economics.

MR. FORRESTAL. Well, people seem to look at it in any event.

CHAIRMAN VOLCKER. So people look at it. It's not reflected in any other inflation figures.

MR. FORRESTAL. Well, whether it's economically significant or not, if there are other factors in the economy that represent an increase in inflation or inflationary expectations, I think that is something we have to be concerned about.

CHAIRMAN VOLCKER. You might just address yourself to that figure, Mr. Kichline. I don't think you mentioned it. I hope your conclusion is similar to mine.

MR. KICHLINE. I'll get around to that. In terms of the price side, for the fixed-weight measure we have 3.1 percent and they have 3.3 percent, so we're off by two-tenths. All of this is attributable to shifting weights--and Mr. Truman's area is part of the problem because it's a quirky thing having to do with oil imports being subtracted out on the import side. We imported less oil and there is no offset showing up in inventories. So, whether or not it is entirely statistical like that--. It may indeed be revised away.

If not, we would anticipate that the following quarter we could be surprised with a more favorable outcome.

CHAIRMAN VOLCKER. We have virtually no increase in producer prices this quarter, apparently a moderately low increase in consumer prices, and the fixed-weight index declined or actually, I guess, stayed the same. I don't think you should worry too much about the GNP deflator.

MR. BLACK. Does this mean, Jim, that you think the real part might be a little larger?

MR. KICHLINE. No. You mean in terms of the current quarter, right? I think basically what is happening is that they have taken something out in one place and they don't see it appearing in another place. When all is said and done, it may well be that we will get lower nominal and somewhat lower prices.

MR. BLACK. At about the same real--?

MR. KICHLINE. Correct. Well, we have a real number that's higher than their 2.1 percent, so that's open to question--whether it will get revised up or whether we are wrong.

CHAIRMAN VOLCKER. We're expecting a higher real number and they say that real is going to be too low. Maybe it will be, but when you look at the assumptions they have made to put that figure together you're not automatically led to that conclusion. They assume that the trade balance will diminish from the January figure to a not very high level. All that has to happen is to have a higher trade balance. If it ran at the January level, that's going to knock off half the GNP growth that they have. They have no cutback in inventory accumulation; in fact, they have a slight increase from the January level, if I remember. These are figures they don't know at all and nobody knows at all. But just glancing at it and making some judgment, I don't think you can argue that the assumptions they have made are wildly on the down side. If I were making those assumptions, I would make them the other way. We just don't know what the trade balance is and [whether] production is flat or down.

MR. FORRESTAL. In any event, although I would lower my general thinking about GNP somewhat as a result of what has happened in the first quarter, I'm in general agreement with the forecast in the Greenbook. I personally think that the outlook for 1985 still looks pretty comfortable. Perhaps, as has been alluded to here earlier, the markets and market observers have become used to some rather high numbers in terms of GNP, and when the numbers move down to the trend rate people get a little excited. I'm not sure we should do that. I think we have to adjust our thinking to lower rates of growth and the view that those lower rates of growth are not necessarily bad. So, I'm not particularly gloomy about 1985. I think we're going to continue to have good sustainable growth in the economy. The forecast for the dollar, I suppose, is as reasonable as one can think at this time.

I would just like to repeat something that was said earlier. In my District, too, I continue to hear over and over again this cry for protectionism as a result of imports, particularly in the textile

and apparel industries. Indeed, some bills already have been introduced by Georgia Congressmen with respect to those industries. My real concern relates to the fragility question but not so much because of what happened in Ohio. There apparently hasn't been any particular spillover from that, except perhaps in attitudes; I am more concerned about the state of the thrift industry generally, including insured thrifts. We have that FCA situation overhanging the market, and I think that is a very serious concern that I'm sure we all share. In terms of what this means for monetary policy, I think we should certainly not do anything to loosen policy. My own preference would be a very slight tightening of policy. I won't go into any specifics at this point but I would like to see us at least hold where we are and perhaps move a bit more toward a tightening posture.

CHAIRMAN VOLCKER. Mr. Corrigan.

VICE CHAIRMAN CORRIGAN. As far as the economy is concerned, I too have a pretty murky crystal ball at this time. We have a forecast that actually is a couple tenths stronger than the Greenbook forecast in terms of real GNP. I don't see any particular reason to change that right now, although I would concede that the balance of risks at this point seems to be on the down side rather than the up side. I do think that business attitudes, and perhaps consumer attitudes as well, have soured a bit even since we met last. As has already been said, part of that reflects the now broad-based--verging on universal--concerns about imports and the way in which they are affecting the domestic economy. I myself also sense a renewed sense of skepticism, notwithstanding Mr. Domenici's efforts, on the budget. At this point I think that skepticism, at least as it reaches me, is bordering on cynicism. Obviously, the Ohio situation and related problems have taken some toll; I'll get back to that in a minute.

On the price side, I don't pay any attention to the GNP deflator but I must confess in dissecting the producer and consumer price indexes for the last couple of months, I do see a couple of things there that bother me. I can't imagine why they are there. For example, in the wholesale area for finished goods--or producer goods or whatever we call them now--there was a detectable uptick in the rate of increase in both January and February, which gets sloughed off as being used cars one month and something else another month. I see a little of the same thing, again hardly detectable, in the consumer area. Neither of those things in and of themselves is of great concern; but they are of concern in the sense that I can't imagine why they are there at all under the current circumstances.

I certainly would associate myself with those who say that in some ways the greatest concern right now is this financial fragility. But I end up a little differently than some who have spoken. I must say I am very hard pressed, notwithstanding the efforts of the Comptroller and others, to see any renewed burst of conservatism or discipline in lending policies and financial market practices in general. If you look at just the growth of total credit, you don't see it. If you look at the ways in which activities are being financed off balance sheets and so forth, you don't see it. To the contrary, you can still find--without looking very hard--instances in which banking organizations are moving in the direction of more liberal lending policies in a very deliberate sense. So I would have, if anything, more concern there in that I do not see any real hard

pervasive evidence of the kind of discipline in the financial sector that I think we ultimately are going to need. So far as the Ohio situation is concerned, I think the jury is still out. Karen probably knows more than I do about this, but it seems to me a distinct possibility that we still are facing a situation in which small depositors may end up losing money. If indeed that is the case, I would suggest that the jury may still be out in terms of the psychology of that and how that plays out over time. I'm not sure what to do about these financial soft spots. On the one hand, you might argue that a more accommodative policy would help; but to the extent that underlying discipline isn't there in the first place, I suppose you could argue that a more accommodative policy could hurt them. I'm not sure that we can solve that problem by the conventional kind of wiggles in monetary policy. But I think it is a very, very significant overhang on the overall situation right now.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. Well, it has been made pretty clear, Mr. Chairman, that in some ways trying to describe the economy is like the blind man trying to describe the elephant: It depends on what part of the beast you have hold of. I don't think we should be too surprised about what's going on in the world, or at least in the United States these days, in the sense that some academicians over the years have made it pretty clear that in an open economy, which we have, and with floating exchange rates, which we have, and with few if any inhibitions on capital flows, which is the case, that over time the stimulus coming from a fiscal deficit will be offset largely by a deteriorating foreign trade situation. That pretty well describes what has been going on now for some time in the United States. The weakness in industrial production and the weakness in manufacturing employment that we are seeing simply [unintelligible] that domestic adjustment for our foreign trade weakness. I suspect we're going to see more rather than less of that. The judgment really comes down to what one thinks is going to happen in the remaining months of this year. Just in the time of the 6 weeks since our last meeting our staff has become somewhat more pessimistic than the Board's staff; they wouldn't be surprised to see a second half in which the GNP is growing very slowly and may possibly even be flat. The basis for that rather pessimistic conclusion is the judgment--with which one could easily quarrel, and I assume the staff here would quarrel with it--that the dollar will continue to be strong. Their judgment is that it is not going to weaken appreciably and that the foreign trade situation will continue to deteriorate. Now, as I said, that's a judgment that is controversial, but that's why our particular staff forecast this month is markedly less optimistic than last month and less optimistic than the Board staff's forecast.

Having said all that, I don't really believe that there is an awful lot that we can do through monetary policy that we haven't already done. We have been pretty generous in the provision of monetary and credit growth. I don't think there is an awful lot more we can do to run an expansive monetary policy to cure this enormous imbalance that you and others have so well described on the fiscal side. The bottom line is that I would be one of those to say this is no time to rock the boat. It's not any time to be squeezing down on monetary growth, and I also wouldn't be in favor of trying to accelerate beyond what we've already done. I would feel comfortable

with coasting along near the upper end of this band, as we have been, for the balance of the year.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, when the Ohio situation broke, I was very concerned because in Massachusetts we have more non-federally insured deposits in savings banks alone [than in Ohio] and then another \$5 billion in cooperative banks and credit unions.

CHAIRMAN VOLCKER. They're all run by good conservative Yankees!

MR. MORRIS. Right.

CHAIRMAN VOLCKER. They used to be anyway.

MR. MORRIS. I tried 10 years ago, in collaboration with the bank commissioner, to get a bill through requiring federal deposit insurance on all depository institutions in the state. I didn't get very far. I was afraid in this instance that we'd have a story in the Boston Globe to the effect that what is happening in Ohio is nothing compared to what could happen in Massachusetts and that the paper would list all of the uninsured banks and so on. That hasn't happened. While several of the banks substantially increased their currency orders to be ready for a run, the run has not happened. But we have had one positive effect from it so far, and that is that about 25 of these institutions have applied for FDIC insurance. Most of them are the larger banks and most of them are in pretty good shape, so I don't think there's any question about their getting insurance. If we get enough of them signed up, I think the \$400 million fund that we have will be able to take care of the smaller institutions and we won't have a situation in Massachusetts where the failure of one institution could absorb the whole fund.

On the economic side, Mr. Chairman, you're right that the computer industry is suffering a little slowdown here. But I think that's a reflection not only of an economic slowdown in general but of the fact that this industry had enormous growth last year. Whereas a year ago there was a shortage of semiconductors, now there's a glut; and there's a glut of computer hardware in general. But I noted that in February there was a big increase in new orders for computers; it could be that we're coming to the end of that inventory adjustment problem. A month ago I took the position that I thought the economy would do better than the staff projection. I still feel that way, but the evidence coming in during the past month certainly has not lent any support to my position. I had expected a much bigger bounce from the decline in interest rates than we have gotten. The decline in interest rates may have increased the demand for money but it doesn't seem to have increased the demand for goods and services. Just why we have had such a modest response to what was a fairly substantial decline in interest rates is not very clear to me. So, I'm inclined to have the same view as Ed Boehne: that despite the growth of M1, which has often not been a very good indicator for monetary policy in recent years, it would be wise for us to sit still until we see how the numbers for the real economy are going to go. As I said, they have been difficult for me to understand in the light of the decline in interest rates, the strength of the stock market, and other

indicators that had suggested an upturn in the animal spirits. That's not showing through in the market place, and maybe it will, but until then--

CHAIRMAN VOLCKER. I suggest to you that imports are a great antidote to animal spirits.

MR. MORRIS. Yes, I think you're quite right. You're also right in saying we are in an unprecedented situation here. I don't think our economic history can tell us an awful lot about what the probable future is going to hold when the basic conditions are so out of line with anything we have ever seen before. That again, I suppose, is an argument for not making any big move here.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, the snow is gone in Chicago and I was feeling pretty good until I got here! I think any comments I would make on the economic scene are probably consistent with what I've said at previous meetings. The expansion in the Middle West continues, albeit at a more modest rate than is true with regard to the national figures. But these imbalances also continue. Some of the good businesses are doing quite well; autos and retail sales are examples of that and they anticipate a good year. The bad businesses, though, are not doing well. In some cases they are really doing very, very badly. Agriculture and anything to do with agriculture--capital goods, machine tools, and the like--are examples of that.

A couple of more specific comments: Consistent with what other people have suggested, I certainly am hearing more and more about the impact this high value of the dollar is having with regard to both imports and exports. And I think there's somewhat of a grim, growing realization with the passage of time that the impact caused by this is becoming a little more permanent. There is an awful lot of foreign inventory that has been shipped and is wandering around the country. Distribution channels by and large are in place and I think have been established in a way that is going to be very difficult to break. A lot of production facilities have been closed; I think that's another way of saying that we may have become more dependent on foreign markets than we earlier realized. And I think there's a growing realization of that. Another mini-comment regarding the economic outlook relates to railroad car loadings. I was talking to the CEO of a large company the other day that has a major operating railroad and he commented that this is the third consecutive month of decline in car loadings after 18 consecutive months of increases. There is some noise in the numbers; trucks and barges are taking a bigger part of all this and it's a little hard to track that. But still, there are some commodities that don't lend themselves to either truck or barge traffic that are showing declines. This guy would not suggest that this is a forecast of a turn in the economy. Nonetheless, in the past, it has been a pretty good indicator and I think it's something we ought to keep our eye on.

MR. PARTEE. Is that year-over-year, Si?

MR. KEEHN. Yes, year-over-year. Turning to monetary policy, it does seem to me that despite these cautionary comments, no one that I talk to is suggesting that we face a recession. I think they can

see far enough through the year with regard to their order books and backlogs that they anticipate a continuation of the expansion. It does seem to me that growth in the aggregates has been pretty strong--although perhaps March will come in at a lower number--and that unless we begin to take some corrective actions here and now, we could be in a position later on of having to be a bit more abrupt. Therefore, I'd suggest not something overt but just a little gentle leaning to begin to be sure that we do have control of the aggregates and to preclude the possibility of inflationary pressures later on in the year.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, it's becoming increasingly difficult to remain optimistic.

SPEAKER(?). Gee whiz!

MR. BOEHNE. That's the worst comment I've heard all day!

MR. BOYKIN. In our District, the economy continues to advance slowly. There are areas of concern. Obviously, the energy picture is pretty cloudy right now; you've all read about that. Rigs in Texas are down close to 9 percent over a year ago. While there has been a little stability in the oil price situation, most of the people I've talked to are not very optimistic. The construction side, on balance, is fairly stable; but that's rather misleading because multifamily units have taken a real nose dive. On the other hand, our commercial construction activity is picking up and that had been going at a fairly torrid pace down our way anyway.

The banks, in increasing their lending, have shown rather significant expansion in loans and in the real estate area. Chuck made reference to one of our major banking organizations getting in the press. They have, of course, but that came right on the heels of the Ohio situation. But our other bank holding companies, both major and second-tier, also have been in the press. We had a fairly significant merger called off because [unintelligible] the condition of the two marriage partners, and they decided they had better go their own way. Our largest bank holding company has been in somewhat of a holding pattern and is trying to remain as quiet as possible. In the second-tier group, we have holding companies in Dallas that have all of their problems, including the infighting within their managements, being aired in the newspapers. We have a similar situation with a holding company out in New Mexico where the chief executive officer has been ousted and he has filed a \$35 million lawsuit. All of this is just being spread everywhere and that doesn't instill confidence.

On the economy generally, I have not picked up many comments indicating that there's real concern that we're going to go into recession. I have had a few rather disturbing comments made to me--and this is certainly anecdotal--along the lines that, well, maybe right now is a time where a little inflation wouldn't be all that bad. This is coming primarily from real estate developers. The first-quarter GNP was below my expectations. I do remind myself, though, that we have had little surprises from time to time; whether this one is going to stick or whether it's going to bounce around, I guess is highly debatable. On the fragility side, much as Jerry said, I'm not

too sure that monetary policy can do very much about that, at least in the current circumstances. I would be satisfied personally to stay just about where we are on policy. Any tilt on that would probably be in the direction of a bit of concern about the growth in money.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. Mr. Chairman, I want to comment briefly on the housing market outlook, partly because there have been comments which were rather optimistic in that area that I want to dissent from. If you follow the secondary market reports, it's clear that fixed-rate mortgage rates have been rising week-by-week. There have been some weeks in which the jump has been 10 or 15 basis points. We are all aware that there is a good deal less use of adjustable rate mortgages now. And to the extent that there's a shift in the borrower's purview here onto the [lender's], you're talking about a 233 basis point increase in the stated rate, going from adjustable to fixed on average--at least as far as Freddie Mac data are concerned. The borrowers who are in the lower down payment category are facing higher private mortgage insurance premiums today if they are unfortunate enough to have to use that device. And that premium, of course, goes to the qualification of the borrower as does the higher rate that is shown in the secondary market data. The mortgage insurers are reporting very heavy underwriting losses, which means that their credit analyses are more severe. Some of these companies are going to lose in last year plus this year an amount equal to their whole capital base of only a few years ago. So, they are likely to be slightly more conservative in their underwriting. The same comment can apply to the mortgage originator who faces delinquency rates starting with 30-day delinquencies of 5 or 6 or 7 percent--rates they have not faced in their whole careers, unless they're up in years a bit. And, of course, the rate of foreclosure losses is significant. The motivation of the borrower of having an investment as well as shelter is diminishing in many sections of the country. Indeed, there has been deflation in housing prices in certain price brackets in certain parts of the country. So, for us to attain the forecast of 1.75 million single-family units plus multifamily units I don't think is feasible. Added to the investment downside risk, I think, is a very substantial downside risk in housing.

CHAIRMAN VOLCKER. I just note that prices of plywood have declined by 10 to 15 percent in the last two months to the lowest point since the [unintelligible] of the recession. Lumber prices are not doing a lot better than that.

MR. MARTIN. A lot of them are Canadian.

CHAIRMAN VOLCKER. That reflects part of the import situation; no doubt about that.

VICE CHAIRMAN CORRIGAN. I think it's not even Canadian; they are importing timber even from places far more distant than Canada.

MR. MARTIN. True, true.

MR. PARTEE. How do you feel about multifamilies, Pres?

MR. MARTIN. Well, the vacancy rate is so high and the overbuilding is so substantial that, of course, that too is a vulnerable market. I don't know how a developer looks on the proposed tax changes. I take it there hasn't been enough debate on those to reverse that hold that it seemed to place on the syndicated apartment developer.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. Mr. Chairman, I agree in general with the staff forecast. I also agree with several people who have said that the investment outlook is very crucial to the forecast. A lot of numbers for sectors and for various orders and so forth have been quoted. The only comment I'd add--and in adding this I will say that I really haven't yet revised down substantially my outlook for investment this year--is that the longer-term incentives for investment remain favorable. And I think that, added to the list of the rather mixed or flat [indicators], causes me to think there is still hope in the investment area.

CHAIRMAN VOLCKER. What are those long-term favorable aspects?

MS. HORN. Well, they really go back to some of the law changes in 1980, if my date is right--the sorts of things that I think probably caused the real return on investment to increase over a period of years and gradually put an underlying floor on investment that way.

Turning to uncertainties, so far I think the Ohio situation has had a minimal effect on economic activity. Of course, it has had a larger effect on banking structure, but I certainly agree with Jerry's statement that the jury is still out there. Of the 71 institutions plus Home State that were closed, only about 20 are fully open today. As the week passes we expect several more, and perhaps several large ones, to be added to that list. But eventually, as this situation unfolds, there are some that will not qualify for federal insurance or otherwise qualify to open without recapitalization or, in some cases, that will not be enough and they will have to be merged or acquired successfully in order to keep the depositors whole. Public confidence has been running well ever since the Ohio legislature passed the act that requires federal insurance, essentially, plus some other ways to reopen. And that is being supported by these [recent] openings. But there will come a time when openings will not be so easy--if easy is the word, which it isn't--as it has been this week. Then the realization that either it will be or may be difficult to sell some of these institutions could once again come into the public eye. Having said all that, the financial fragility issue that I really worry about is not so much the Ohio one--though there could still be surprises down the road on that--but the overall one that we've been discussing for months, or maybe even years, around this table. And the fact that we had a very close look at that in the last several weeks and some groups who don't normally take such a close look--that is, individuals and consumers--also had a close look suggests that that group may be particularly sensitive if [they are] hit again. Overall, I do judge the financial fragility issue to continue to be very worrisome.

As for monetary policy, taking all these things together, I would very much like not to find myself in a position three months from now of wanting to make a significant move in monetary policy; and I'd like to end up three months from now in a position where we have a good chance of being in the [monetary growth] ranges by year-end.

MR. RICE. Let me just ask if there were any runs on any of the S&Ls that did open up?

MS. HORN. Of the ones that opened up fully there has been to our knowledge no extraordinary activity whatsoever. Virtually all of them are open on this partial payout basis--that is \$100 [per withdrawal] and \$750 a month per depositor. In those cases there are four of them that have had heavy lobby traffic. But of course the withdrawals are severely limited so the [total] withdrawals are in the realm of reason. And three of those four are ones that had experienced runs before the closing. All in all, I'd say so far the operation has been successful.

MR. AXILROD. It should probably be mentioned, Mr. Chairman, in that context that the amount of borrowing related to these thrifts has risen. Counting yesterday, when it rose another \$4 million, the amount outstanding is \$40.5 million.

MS. HORN. I'd add that since they are open for the partial payouts and such borrowing is permitted to support that activity we would expect borrowing to increase each day for some time now.

MR. BLACK. Karen, if a person has an account in his or her name and a joint account with a spouse--

MS. HORN. Each account.

MR. BLACK. Each account could get \$750.

CHAIRMAN VOLCKER. Mr. Garbarini.

MR. GARBARINI. Well, Mr. Chairman, given your statement about the good conservative New England Yankees, I guess it might be argumentative for me to say that I'm from a District that's in the heartland of conservatism. But at least I can say that we are centrally located and, therefore, somewhat contiguous to almost every area of fragility that has been discussed around this table. On the east we border the problem with savings and loans; on the northeast, central east and northwest, the agriculture problems; and on the southwest, the energy situation. However, because of that location we also touch upon some of the areas that my good friend at the right described as [experiencing] slow advancement, which can only be slow in terms of the standard of living that they've become accustomed to, I would say. So, when it comes to the economy we get very, very mixed signals.

We recently held our initial meeting of our advisory council on small business and agriculture and heard some very interesting comments. We heard everything from statements that the only thing that will save agriculture is a complete government bailout, to statements that certain well managed agricultural areas that paid attention to their cash flows are doing very well, to encouraging

statements that there's still a belief that technologically we have the capability of competing very well in the agricultural area with anyone in the world. Obviously, there's going to be a period of problems for those that did not manage well.

I guess those mixed signals, as John Balles said, make it very difficult to describe the elephant. However, our best estimate would probably be something along the line of the real GNP growth of the staff forecast or perhaps just a little less. Perhaps of more concern to me is the fact that our estimate is also for somewhat greater inflation than the staff sees. And given all of those mixed signals and uncertainties, I would suggest that perhaps the advisable course for the System is to move very slowly and in the areas of its strength. Since I also have a slightly different opinion about what M1 tells us than one good Yankee from New England, I would say we should watch that very closely, not making moves of any magnitude. I would share Karen's concern about having to do something major later in the year. I certainly wouldn't want to see continued front loading of money that would cut our flexibility in the second half. On the other hand, I would hope that we would take any opportunity to continue with what our strength is, and that is to continue the long-range battle against inflation.

CHAIRMAN VOLCKER. Ms. Seger.

MS. SEGER. I want to thank the Chairman for visiting with some of the same people who have been talking to me for the last six months. If there's one theme that I get from these individuals, it's basically that their concerns involve the strong dollar--the surge in imports and the loss of export markets. These people include anyone from farmers to manufacturers but are primarily manufacturers. I heard within just the last couple of weeks, for example, that Ford Motors is closing the tractor plant that's right near where I have lived in the Detroit suburbs because they can no longer manufacture profitably in this country. They're going to move the operation overseas. I would just like to point out that once these movements are made they don't quickly reverse course. The dollar could take a dive in six months and it's unlikely, in my judgment, that they would then move back. So, I think the longer this goes on the more serious the consequences. And I don't think that we should take them lightly.

Another thing I'd like to mention involves what I see as the risks in the staff forecast. As a cynic looking at consumer spending, what I see besides a lot of the spending going to imports is a lot of spending supported by credit--those magic plastic cards and things like that. In the auto industry, particularly, there are special terms--extending from 4 years to 5 years the term on a new car loan in order to get the monthly payment down sufficiently to qualify a buyer. You're living on borrowed time when that goes on to a very great degree. Also, there are tremendous special rate inducements; 8.8 percent is one number that you see, again as a means of trying to drag the people in off the streets and to get the monthly payments down so that they qualify. I think this is producing some good auto sales numbers at the moment, but it is the kind of foundation that to me looks like mush. The risk in business fixed investment has been mentioned by numerous people but I will repeat it. There are high vacancies in office buildings; there are major lags here and I don't think we've seen the full impact of these tax reform proposals on

business spending. In the multifamily residential area, I would say ditto. There are substantial vacancies in apartment buildings and, also, I don't believe the tax response has shown up entirely.

In terms of the dominant factors I think we should look at--and maybe this reflects my background, having held their hands and nursed the sick thrifts in 1981 and 1982--I see this fragility of the financial system as going far beyond Ohio. It is not that Ohio was an unimportant event. It certainly was a media event and made a lot of individuals aware of this problem. But I think there would be a lot of sick people around this country if they knew the condition of the rest of the thrifts and if they knew that probably a good 10 percent will go in the soup between now and sometime next year. And that's not because of somebody dipping in the till or a governor acting overly enthusiastically. These are fundamental problems with solvency and insolvency. And think what that does to FSLIC. To me it's like being reinsured by somebody who is three weeks from bankruptcy rather than bankrupt already. But I don't think that that word is generally out and that the problems are generally appreciated.

The other factor I think we ought to give primary attention to in formulating monetary policy is this dollar strength that I've already referred to. I would be extremely concerned about any further rise in interest rates. I don't care if M1 growth goes to 37 percent next month, which I don't think it will. But this is the one thing--in case people haven't followed the thrift situation carefully--that does impact on thrifts very directly. It is the one thing that we do have an influence on that does hurt them or does influence them. If the increase in money market rates that has occurred since the last FOMC meeting--30 to 75 basis points or whatever it was--would just go on to total one percentage point and if that were factored into the cost of funds for thrifts, it would put somewhere between 50 and 75 percent of the industry in a loss situation. And that's on top of the ones that are already staring at insolvency. So, I think that interest rates are the connecting link and I don't think that we can ignore them if we're really concerned about this fragility problem. In fact, if I had been told at the last FOMC meeting that Steve and Peter would have been producing interest rate increases of 30 to 75 basis points, I would have dissented. So I hope that our move today will be moderate and that whatever we do we will take careful notice of what our steps are doing and will be doing to interest rates.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. My comments with regard to the economy are brief. Let me start by saying that we're in general agreement with the staff's forecast. I cannot quarrel with the comments that have been made that if there's a risk, the risk may be on the down side and not on the up side, because I don't see anything that indeed will move us to a higher level of output than has been forecast. Nor do I really see anything on the down side that will alter the judgment that that forecast is about right.

I would, however, just note that the Tenth District probably is one of the better illustrations of the imbalances that exist within the economy that have been described. For example, on the plus side: we have a fairly large producer of automobiles--I think second in the nation--and that's going full out; the high-tech and defense industry

is booming; commercial construction, at least in Kansas City and Omaha, is very vigorous. Aircraft production is a big component part of our activity and I've received an interesting report on aircraft most recently, and that is that the number of aircraft being produced is down, largely because of the inability of the aircraft producers to export. On the other hand, the dollar volume of aircraft being produced and sold is up simply because there has been a switch from the smaller type of aircraft back to the business jets, such as turbo jets, whose sales were dead in the water a year ago simply because business wasn't investing in that kind of capital good. So, there are parts of the economy that are faring very well. On the other side, I won't belabor the points on the energy, mining, and agricultural areas in which our District is very deeply involved, but all of them are flat on their backs.

As for the fragility, there is fragility and it will begin to show up in the agricultural banks during 1985 as it has in the past. And I think that will accelerate somewhat. But there don't appear to be situations that can't be managed by the FDIC and by [FCA] and otherwise. But there will be a great deal of discussion about them as well as about the bankruptcy or the ceasing of business by the implement dealers, the grain dealers, and others that have been very important to the Main Street merchant in these small agricultural towns. And the impact is going to be very great.

Just as a matter of personal interest, perhaps, there was a sale of a farm of some 700 acres in the little town of Platsburg, Missouri, and some 500 to 600 people showed up--mostly farmers and UAW retired workers--for whatever reason, to protest the sale on the courthouse steps. The farm was sold amid shouting and there was violence; there were 7 or 8 arrested, several injured in the melee, and they damaged the front doors to the courthouse where the sale took place. The reason I recite that event is because: (1) it does perhaps portend for the future what may happen as these farm sales increase; and (2) one of our ex-colleagues, Willis Winn, has his home in Platsburg, Missouri. I don't know that he was in the middle of it, and I doubt that he was.

MR. PARTEE. It wasn't his farm was it?

MR. GUFFEY. This happened on the 50th anniversary of a similar event in 1935 in which a federal marshal and his authorized [agents] tried to sell a farm on the courthouse steps of Clinton County in Platsburg. It was an unsuccessful sale; the crowd took off his pants and ran him out of town. They are more sophisticated now than they were 50 years ago.

Turning to monetary policy: In my judgment, staying about where we are would be appropriate for the upcoming period and even for the three months of the second quarter. But I do have a concern that we not get ourselves in a position of letting money expand so rapidly that it takes all the flexibility away from the second half of the year and does not permit us, without some drastic moves, to get back within the bounds of the limits that we set for money growth at the last meeting. I would note also that we have been fairly expansive in money growth over the last three or four months and if there's any lagged effect of money growth on real output, then I think we shouldn't get too exercised at the moment about easing policy. In

view of my concern about not getting caught in the last half of the year, then, I would be leaning to the side of snuggling up just a bit through this second quarter.

CHAIRMAN VOLCKER. I think we can go help the farmers by eating a doughnut or two!

[Coffee break]

CHAIRMAN VOLCKER. I detected a consensus on only one point: We're in a very difficult set of circumstances. I haven't heard anybody arguing for very bold moves in any direction. They may be justified, but I don't detect that we're in the mood to act on that. Given that we're in a very narrow sector, I'm not sure that what we do here is going to have major implications for the course of events in the next few months. We'll see what happens. We didn't talk much about all the contingencies that could happen later in the year, mainly revolving around the dollar and the budget. Nobody knows. If the dollar goes up much more, our dilemmas will be aggravated. If it comes down sharply, we'll have a different set of dilemmas but maybe a clearer set. A very steep drop in the dollar would give us, I think, some sense of the outlook turning more favorable over time, though maybe not immediately, but it also potentially could give us some inflationary problems. But I don't see what we can do to deal with that now. I don't think there is much we can do either about all this fragility in the short run [save] in some sense not aggravating it. I do think we are getting a very rapid growth in debt but I'm not sure we can do much about that either. I think that reflects some of the underlying imbalances in the economy. In the natural course of events it seems to me [appropriate] to remain somewhere around alternative B. We did have this fact that has been alluded to that borrowings have run consistently above what we started out to maintain, anyway--I suppose technically in part because excess reserves kept running above what we had assumed they would run. If one were starting with a notion of "unchanged" one has to define what "unchanged" is--whether it means borrowings or net borrowed reserves. Presumably we have been using borrowings recently. I must say that I think an overt tightening step at this stage--given the uncertainties in the business picture, the height of the dollar, and the financial markets--could turn out to rank as one of the more unfortunate bits of timing in our history. That's about where I am.

MR. RICE. I agree that this is not the time to tighten. But it's also probably not the time to allow money growth to expand substantially above the band.

CHAIRMAN VOLCKER. Suppose those two doctrines are inconsistent?

MR. PARTEE. By tightening do you mean interest rates?

CHAIRMAN VOLCKER. I didn't say that.

MR. RICE. Right.

CHAIRMAN VOLCKER. I suppose you could say by tightening that you mean reserve positions; that's what I mean.

MR. RICE. I think the danger of allowing M1 to continue to grow at a rapid rate is that people eventually will conclude that interest rates are going to go up and we're going to have to tighten. And we don't want that either. So my own feeling is that the best way to deal with our dilemma is "steady as you go." And, as you point out, the problem is to define that.

MR. PARTEE. Alternative B, if it works out, would cruise us right along this upper band for the time being. That seems to me not a bad outcome if we could get it. Fortunately, we have had this [slowing in] March; without March things really would be looking very grim.

CHAIRMAN VOLCKER. The latest very fragmentary numbers suggest that March might be just a touch higher than estimated. I don't think enough--well, we just don't know what it is. It could change from week-to-week. It's not enough to make a significant difference.

MR. WALLICH. Well, "B" means that all year we're going to be above the cone but we'll still be coming in approximately at the peak, at the [upper] end of the band. We have said that we might come in at the higher end. We have absolutely no margin here and this is what would concern me. If we get a further overshoot, then we'll be confronted with a need to do something two months from now that might be more drastic than what we would have to do now to slow it down. On the other hand, it--

CHAIRMAN VOLCKER. It depends upon the environment in which we're operating. We don't have to slow it down.

MR. WALLICH. Yes. Well, it might well happen that we're taken off the hook by some development and we might wait for that, in that it is obvious that all the considerations relating to interest rates are adverse to any kind of tightening. Just name them: they are all negative except for the slowing of the money supply that I would like to bring about. If we can rely on March perpetuating itself at a reasonable rate, one can take that chance.

CHAIRMAN VOLCKER. Nobody knows. Although I guess that is the best econometric estimate--not quite perpetuating itself but that it is consistent with "B."

MR. AXILROD. That's right.

MR. KEEHN. I'm a little unclear on the current borrowing level and where we really are; perhaps Steve and Peter could clarify it. I have somewhat the feeling that we have been operating at a higher level since the last meeting than perhaps the target and that, as a consequence, the current level would take us someplace between "B" and "C." If that's right, that might suggest that "B" in fact would represent a slight easing from where we are. Is that a reasonable statement of the case?

CHAIRMAN VOLCKER. The borrowings have been running higher, that's for sure.

MR. STERNLIGHT. We have been aiming at \$350 million of borrowing but, as I said, for a couple of reasons--the main one being the greater demand for excess reserves--it has come out higher. I think particularly in that reserve period when borrowings averaged over \$600 million there were some really special factors. Perhaps more indicative is this current reserve period when it's averaging about \$470 million thus far. And even there I think it is probably being lifted some because of the greater demand for excess reserves.

CHAIRMAN VOLCKER. When we have borrowings this low--and we had a couple of days when some big banks borrowed a large amount for what might kindly be called technical reasons--

MR. STERNLIGHT. There were times like that.

CHAIRMAN VOLCKER. They mismanaged their reserve positions. And when we're operating with borrowings in this range, a big lump is enough to affect the weekly average. One of them was \$1.5 billion or something like that, I think, in one day. For a two-week period that's \$100 million--and for a one-week period, \$200 million--on the average. And it kind of comes out of the blue; the market wasn't all that tight but they--

MR. AXILROD. Another way to look at it, President Keehn, is that implied free reserves, so to speak, with \$600 million in excess and \$350 million in borrowing, are \$250 million. In the first two-week period those free reserves ended up at \$230 million but with \$800 million of excess and \$570 million of borrowing. In the second two-week period--the one that just ended, not the one we're in but the previous one--free reserves ended up at \$110 million with \$641 million of borrowing and \$751 million of excess. When that period ended we thought the excess was \$932 million. It has been revised down. So in that sense, we've been right around the path but borrowings came in high early and tended to stay up there [because of] occasional days of large borrowing.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. Well, it looks like alternative B with a hope and a prayer--that we start out the period with reserve positions about where they are. But I think we have to keep an open mind as we go through the next several weeks about the case for some snugging up there. There is a lot of wisdom to the point that you've made that we don't want to use up all our flexibility for later in the year, although one just can't lay out very precise contingency plans in terms of under what circumstances one might snug up or not. But I would start the period about where we are and keep an open mind--a fairly symmetrical open mind about what might happen as developments unfold through April.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. In order to glorify the obvious, let me begin my statement with a reminder that we set the upper limit on M1, in my opinion, low relative to our assumptions about velocity this year. We attempted to give ourselves some running room by not reducing the upper limit of M2 and M3 so much. As you know, we came down from an 8 percent upper limit on M1 to 7 percent. It seems to me that lies

behind the projection that we will run along the top of the so-called band with alternative B, which I support. Apparently, M1 is decelerating. The Chairman has indicated that the first estimate may be modified somewhat. I'm a little troubled that the results in the three econometric models that I follow seem to agree right now, which always gives me pause. They seem to agree that M1 at least, and also M2, will be coming down in this quarter. Secondly, we have the possible weakness in velocity, particularly in V1 that we discussed in February. I don't know what the velocity was in the first quarter but it must have been a minus 3 percent or something like that--7.4 percent compared with 10.3 percent. If we have flat or negative velocity, then to run along the top of the band does not seem to me to be that risky. Once again, I think these cones and bands are useful tools, of course, but I am very encouraged by the universal awareness here of the risks in the economy in so many of the real sectors and so many of the financial sectors and in the international and domestic situation. [Unintelligible] some slight difference from a band, the top of which was set in order to give a certain long-run signal, given the almost unprecedented risks matrix here, both real and financial. It seems to me, given the uncertainty with regard to velocity and the high probability of having a negative 1 percent or something of that sort, that around 7 percent is not an untoward goal for M1. So, I support alternative B. I support the \$350 million borrowing and a reconsideration at the July meeting of the upper limit of the M1 band.

CHAIRMAN VOLCKER. Mr Keehn.

MR. KEEHN. Well, let me try to make a case for something between "B" and "C" if I could. First, we did establish the ranges for the aggregates just a few weeks ago. And in your testimony I think you made it clear with regard to M1 that, with some caveats, we would be within the range but certainly within the upper part of the range. I think the earlier conversation around the table would have suggested that there are some greater risks this time than perhaps at the last meeting; nonetheless, nothing that I heard would cause a specific downward reduction in our forecast. The risks may be on the down side but they are not enough to suggest a downward revision in the forecast itself.

CHAIRMAN VOLCKER. The staff did revise the forecast downward a little.

MR. KEEHN. Well, I'm talking about in a really major sense. I have a feeling that maybe we are currently between "B" and "C" and I would be in favor of maintaining the position that we have now with perhaps a slightly higher degree of pressure. Therefore, I might suggest for M1 a growth rate of, say, 6 percent, and a borrowing level of between \$500 and \$600 million, or in that area.

MR. PARTEE. \$500 to 600 million?

MR. GRAMLEY. What sort of a funds rate does that likely give rise to?

MR. STERNLIGHT. 9 percent or higher. Higher than [unintelligible], particularly if we continue to use something like the current excess reserve number. Frankly, if the demand for excess reserves continues to run ahead of what we're using now, then I think

the borrowing is going to tend to come out, say, \$100 million or so higher than what we plug in there.

CHAIRMAN VOLCKER. It looks like we're doing something wrong. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman we have a conflict between M1 and the economic data. It seems to me that the more sensible thing would be to stay where we are until we see how this conflict is resolved. If we have a second quarter of strong M1 and relatively sluggish economic indicators, as we had for example in 1982, then I think we simply have to revise the target for M1. I think there is a real possibility we might have to do that. But in the meantime, I think alternative B is the most sensible course.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. As I mentioned earlier, I think a lot of the economic success that we've enjoyed in the last year and half or so stems in part from our having done very well in meeting our M1 targets. In the last half of 1983 we came in about on target and we came in pretty closely on target for 1984. If, after our next meeting, it becomes apparent to the markets that we have aimed for a point such as "B" or "A," which both are well above this upper band, then I think that's going to lead people to assume that we've thrown in the towel on inflation. I'd be very disturbed by aiming at any point above that upper band. As Roger suggested--and Steve and others made the point--if we do get to that point, then we have to make a pretty wrenching effort to get back to our targets and that involves obvious risks. So, as Steve stated very well, I think a little move now might go a long way; so I would come out preferring a path something like "C." I could live with something a little higher than that as long it weren't above the upper band and I think Si's suggestion of a borrowing range of \$500 to \$600 million would be about right. But what is more important to me than anything else is the reactive mechanism. What are we going to do if we find that the money supply isn't doing what we think it will do? It may be that we can actually stay within that range with falling rates. We really don't know because when the market is that tight the money supply is pretty hard to predict. So I think it would be a good idea to use an asymmetric directive that would require us to react much more strongly if we start showing too much [money] growth. I'd use "would" on the up side and "might" on the lower side, if it becomes weaker.

CHAIRMAN VOLCKER. Mr. Stern.

MR. STERN. I would generally favor the specifications of "B" with one modification that I will come to in a minute. I would favor "B" with a symmetric approach to the directive, with the intention of not doing anything overt to change reserve availability immediately. Nevertheless, the one modification I would suggest--and this might be in the nature of splitting hairs--is reducing the [March to June] M1 target associated with alternative B to 6 percent. I think that might do a couple of things for us. One is that to the extent the long-run targets that we agreed to at our last meeting are appropriate, it seems to me it makes the second half of the year a little easier. That's one reason for doing it. But more fundamentally and more importantly in my mind, given my view of the economic outlook, I think

that kind of target is certainly appropriate and would be associated with what I consider to be at least an adequate, and maybe a better than adequate, economic performance for the balance of the year. It seems to me that the practical implications of that modest reduction in the M1 target would be that we wouldn't have to do anything immediately in terms of reserve availability, as I said, but it would put us in a position where if money continued strong--as it has with the exception of March for the past few months--we could at least be in a position of considering whether we want to do something about it or not.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. Well, Mr. Chairman, I think the case has been pretty well made that we have all these uncertainties and that there is really not a compelling case, if you consider alternatives A, B and C, to make any bold moves. Contrary to our usual admonition of "Don't sit there, do something," I would recommend the opposite approach this month: "Don't do something, sit there." I'd vote for "B."

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Because of the uncertainties that we've talked about in the economy and some of the strains on the financial industry, I would be inclined to accept the monetary specifications of alternative B. But if there were a bias, I would want to tilt a little, just a bit, toward snugging. The way I would do that would be not to push the borrowing back down to the \$350 million level but to have it somewhere between \$400 and \$500 million. I think that might give us just a tad more pressure on reserves. Given the bias that I prefer, I also think that we should not respond to slower growth of money on the down side, so I would favor an asymmetrical directive.

CHAIRMAN VOLCKER. Mr. Corrigan.

VICE CHAIRMAN CORRIGAN. I too would generally associate myself with alternative B but, for the reasons Mr. Stern mentioned and one other, I would favor having the M1 target at 6 percent--6, 7, and 8 percent [respectively for M1, M2, and M3]. In addition to the reasons that Gary stated, I think we have potentially a bit of a public relations problem in that 6-1/2 percent--and this really is splitting hairs--puts the target for the quarter above the parallel line. Against the background in which you and others of us have been saying that if there's a "change in policy" we would communicate it, I think that aiming at something that would be a hair above the parallel line at this point is susceptible to interpretation as a change in policy. So, I would like to see the 6 percent for the substantive reasons mentioned but also because it would just about kiss the parallel line.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. I'm concerned, as many are, that over the long run--that is, the next 5 years or so--we will have an inflation problem that is probably going to get worse when the dollar begins to fall, so that less money growth is better than more. So, I would prefer to see the growth of M1 come in lower than 6-1/2 percent; but I wouldn't want to do anything to force it to do that. I like Ed's

prescription of prayer better than Si Keehn's of raising the borrowing level to \$500 or \$600 million. It may be that by midyear we will regret this. But I don't think one can assume that, simply because money might be at the upper edge of the parallel line--maybe not even in close enough contact for an intimate kiss--at that point. I think we have to decide that later; we have to wait and see what economic conditions look like at that time. Six percent might make sense, cosmetically, for the M1 target for March to June. What I worry about, however, is that if we get a speed-up of tax refunds, we might have an increase in money growth for that reason, which really wouldn't make any significant difference to the course of economic activity. What I'd like to do is to adopt a course of policy now that keeps us really where we are. I don't want to see the fed funds rate go up to 9 percent and I don't want to see it go back down to 8 percent. I would like to see it hover in the range of 8-1/2 to 8-3/4 percent, or even 8-5/8 percent, which is about where it has been recently. I have a hunch that maybe we need a little higher level of initial borrowing than \$350 million--maybe \$400 million or somewhere around there. But the sense of my prescription would be to stay pretty steady at this time.

MR. MORRIS. Do you think the Committee ought to hire a chaplain?

CHAIRMAN VOLCKER. Governor Seger.

MS. SEGER. I guess I would like to begin with a question. Is the borrowing target really a target or isn't it? I sit here and I hear these numbers; yet at the next FOMC meeting I see what we come in with--

MR. STERNLIGHT. Well, it is the number that's used in constructing the path for nonborrowed reserves, and the nonborrowed reserves are a target.

CHAIRMAN VOLCKER. Well, that isn't exactly my understanding. I think we tried to explain that in a memo a couple of meetings ago.

MR. AXILROD. It's very hard to control the distribution of reserves--other than nonborrowed--between borrowing and excess. It's very hard to control the distribution of free reserves. The market will tend to do that. Now, one can observe it as it comes; but if the market has the slightest idea that funds might track up for one reason or another [unintelligible] the borrowing will tend to come in early in a two-week period. And if it's high enough early enough, it's hard ever to get it down to target and that will manifest itself eventually in the excess reserves. Some of it we will take out in hitting our nonborrowed target but we won't take out all of it. So, to a great extent we're at the mercy of the market in that distribution. And I would think that the funds rate recently probably has been a bit higher than either Peter or I would have expected early in the period.

MS. SEGER. It's higher than I thought I understood at the last meeting.

MR. AXILROD. But it's not that much higher, I think, than if you had \$350 million of borrowing and the same free reserves. If you had \$500 million of borrowing and the same free reserves, it may be a

little higher--perhaps an eighth of a point, I would guess--but it isn't very far off.

MS. SEGER. At some point, though, do we at this Committee meeting have to take into account these changing attitudes toward excess reserves?

MR. AXILROD. That's something Mr. Sternlight can gauge in the course of the two-week period. All he can do is see what's happening to excess reserves and try to gauge a sense of the demands using whatever information we have, including how the funds rate is moving and what we think is governing the distribution of reserves.

MS. SEGER. Well, okay.

MR. STERNLIGHT. We have been doing that recently. We have been making an allowance in this current reserve period; even though \$600 million is in there for excess reserves, we've been thinking of it as somewhat higher and not rushing in to take out what has looked over the last couple of days, for example, like more than enough reserves for the path.

MS. SEGER. It still seems that we're getting more of an interest rate impact than we expect or plan for at these meetings.

MR. STERNLIGHT. Slightly more.

MR. AXILROD. Well, Governor Seger, let me make just one more point on that. As I think was explained in the Bluebook, when money was running high, the borrowing assumption was thought to be in the \$350 to \$400 million range, so there was the merest little tilt in that sense. It probably got a little tighter--a shade marked up--[but] that has been reversed.

CHAIRMAN VOLCKER. We ended up with more borrowings than we intended, more excess reserves than were assumed, and we had somewhat higher interest rates than one might have guessed. But the Committee isn't operating on an interest rate target. If we wanted to operate on an interest rate target, we would; that's a decision the Committee could make.

MS. SEGER. I understand that we're not operating on an interest rate target. But when we're trying to look at the various alternatives, one of the things I look at is what the expected interest rate impact will be given one choice versus another. And that's all I'm saying.

CHAIRMAN VOLCKER. There's a certain temptation--

MR. PARTEE. Sometimes they're wrong.

MS. SEGER. In terms of the alternatives, if I had to choose among them, I'd take alternative B but with a tilt toward "A" rather than a tilt toward "C" because of my concerns about the impact of any additional increase in short-term interest rates on the financial system.

CHAIRMAN VOLCKER. Mr. Garbarini.

MR. GARBARINI. Well, Mr. Chairman, I expect to pray to the Lord to get His attention then have Him judge me on my actions. There is a lot of uncertainty. I would agree with much of what has been said by Jerry and Si. Although one might say that they differ, I think they differ only in the degree of the way to go about this. Since my bias is toward continuing to make sure that we don't over expand, I would be tempted to lean toward "C." But given the uncertainties and other considerations, I would say something in between "B" and "C" with--sharing Si's feeling--perhaps a slightly larger borrowing target.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I rather like what Lyle said. I think, cosmetically, it would be desirable to put in a 6 percent M1 and we can review later whether or not we want to change the upper limit. But for now, I think the notion that growth would be running pretty parallel with that upward path line is a pretty good one. I think maybe the borrowings number could be snugged to \$400 million, which is very little change. In fact, it may be a little easing from where we actually have been. But I wouldn't go as far as Si has suggested. I'm wondering if there are times--and I think there are--when it is desirable to pay more attention to the markets and less to the aggregates. And since I agree that it could be pretty destructive to have a sizable, significant, appreciable rise in the funds rate at this point, I wonder whether we shouldn't reduce [the top of] that range to 9 percent.

CHAIRMAN VOLCKER. On the funds rate range?

MR. PARTEE. Yes. Maybe we ought to lower the rate to indicate some symmetry on this; perhaps we ought to raise the 6 percent [lower limit], but I think not. In any event, I think there ought to be an understanding that if following the course we're following is likely to take the funds rate above 9 percent, we certainly ought to talk about it. And perhaps we ought to signal that to the market by putting that in the directive.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I would favor alternative B with a modification to 6 percent [on M1 growth], making it 6, 7, and 8 percent, with borrowing of around \$400 million.

CHAIRMAN VOLCKER. Who else do we have here?

MR. RICE. Do you have me, Mr. Chairman?

CHAIRMAN VOLCKER. No.

MR. RICE. I would favor the specifications of alternative B as presented, with \$350 million on borrowing, because I think they are most likely to keep us where we are and are most likely to result in an 8-1/2 percent funds rate. I can live with any kind of refinement or fine tuning that would increase the chances of our staying at around an 8-1/2 percent funds rate.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I would join those who would opt for a 6 percent target for M1--in other words, just a modest modification of alternative B for the reasons described by Jerry Corrigan and others. Clearly, that would imply maintaining the existing conditions, whatever that may mean. Therefore, in my mind it comes down to what borrowing level should be adopted. I would join those who would adopt a level in the \$400 to \$500 million range, tending toward \$450 million I suppose, because based upon past experience it seems to me that we're talking about someplace around 8-1/2 to 8-5/8 percent as existing conditions with respect to interest rates. What gets us there is not clear, but it seems to me it would be something more than \$350 or \$400 million--something more in the \$400 to \$500 million range.

I would just note that in the Bluebook there is a recognition of the seasonal borrowing and that the Desk would intend to accommodate the seasonal borrowing starting with a level of about \$80 million in the current time period and increasing upward. Looking over the last three years, the second-quarter average for seasonal borrowing is something around \$200 million, based upon the old seasonal borrowing privilege. Taking into consideration that we not only have a new temporary seasonal provision but we have expanded the regular seasonal provision to encompass a great many other banks, I hope the Desk will be mindful that that could explode on us, if indeed there are creditworthy borrowers out there to whom banks can pass through seasonal credit.

CHAIRMAN VOLCKER. Are you getting any demand for that?

MR. GUFFEY. No, as a matter of fact the demand that-- Well, first of all, are you talking about the temporary?

CHAIRMAN VOLCKER. Well, either one.

MR. GUFFEY. The seasonal borrowing is at a very low level at the present time. I think the numbers are presently about \$80 million nationwide, whereas in past years by this time we would have been up in the \$150 million or so range and then would accelerate on up from that point. And we haven't seen that.

CHAIRMAN VOLCKER. It's lower than normal.

MR. GUFFEY. It is lower than normal.

MR. AXILROD. Well, in 1984 and 1982 the spread of the funds rate over the discount rate was much higher than it is now. And in 1983 it was considerably less. So, the tendency of seasonal borrowing is to rise, obviously, from February to March but the level around which it fluctuates is affected by that spread.

MR. PARTEE. You haven't had any inquiries for seasonal?

MR. GUFFEY. No, as a matter of fact, it's interesting: I think they're sitting on their hands. The other aspect of this is that of the \$650 million government provision--that is, the guaranteed loan program--only \$8-1/2 million has been used. Nobody knows what to do, I think.

MR. KEEHN. Chuck, we have had a lot of inquiries; there is a tremendous amount of interest. I think people have reaffirmed that the problem was not liquidity but rather asset quality. Nonetheless, there have been a lot of inquiries and a general appreciation that, having faced the problem, we've developed a solution to try and deal with it. But no takers--

MR. PARTEE. No takers.

CHAIRMAN VOLCKER. Well, two left [to speak]. Mrs. Horn.

MS. HORN. I would favor a borrowing level of about \$500 million; that would put me in the "B minus" range. And I think the adjustment from 6-1/2 to 6 percent on M1 would be appropriate.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Well, at the margin, I could live with "B" as is. I would prefer it to be tightened a little to borrowing of \$450 million and would accept a very mild increase in the funds rate and an M1 [target] at 6 percent.

CHAIRMAN VOLCKER. Well, we have a great desire for "B" if people know what "B" means. Just in terms of the numerology a number of people have said 6 percent [for M1 growth], and I would declare a victory for 6 percent on the simple basis that it's a round number.

MR. PARTEE. Right.

CHAIRMAN VOLCKER. It's a wonderful 6, 7, and 8 percent, and it will have no discernible effect on what we do! Now, whether the borrowings will have a discernible effect on what we do, we have some differences of opinion. My own bias would be on the lower side of that. In all this hypothesizing about what we might do, it's easy if money runs low; if it runs high, I'd want to know if it was running high after three consecutive months of decline in industrial production and the dollar 3 percent higher than it is now or whether it was running high with industrial production rising and the dollar falling. Then I would have a quite different attitude. I don't know how you forecast that at this point. And that's my problem. I have a sneaking suspicion that one of those is more likely than the other, which biases my attitude toward this a bit. The low end of the preferences on borrowing is roughly the \$350 to \$400 million range; then there are those who said a \$500 million range and those who said \$500 million or more.

MS. SEGER. I wanted \$350 million; I don't think I said it.

MR. RICE. Is borrowing at \$500 to \$600 million consistent with a 6 percent growth in M1?

CHAIRMAN VOLCKER. Who knows? According to the analysis, \$350 million is consistent with--

MR. RICE. Well, that's my point. I would think that--

CHAIRMAN VOLCKER. \$350 million is the midpoint of the range of our experts' [views] after examining all the entrails.

MR. PARTEE. Well, \$500 to \$600 million is going to put the funds rate under upward pressure isn't it? We didn't get an answer.

MR. RICE. That's what it says here.

MR. AXILROD. It's hard to answer, but I would say that we would use whatever borrowing assumption the Committee arrives at to construct the path and we will make an excess reserves assumption. Let's say it's a little higher than \$600 million--suppose it were \$650 million. We will use that excess reserves assumption no matter what level of borrowing the Committee arrives at. So, if the Committee arrives at a level of borrowing at \$500 million and we're assuming excess reserves of \$650 million, in my mind, that would be a tighter reserve position than we have had over the previous period, comparing say, \$350 to \$400 million and \$650 million. And that probably would lead to a funds rate somewhere above 8-1/2 percent, maybe 8-3/4 percent rather than one possibly below 8-1/2 percent or maybe 8-3/8 to 8-1/2 percent, which is my rough guess in relation to alternative B. Mr. Sternlight may have a somewhat different view.

MR. STERNLIGHT. No, I think that would be--

MR. PARTEE. Well, maybe what we ought to do is have an agreement as to net borrowings rather than borrowings.

CHAIRMAN VOLCKER. Well, I'm not so sure about that. No, I think that would be a mistake, because we might get more demand for excess reserves. If we set a net borrowing target, that's putting more pressure on the market; I think that's in effect what happened last time. And I think we would not be getting the results that we wanted. What we do is make some judgments ex post, as a result of this meeting, that we have made an excess reserve assumption that is too low, though too low is a kind of qualified [assessment]. We didn't mind that so much when M1 was rising rapidly. If the business news isn't too weak or isn't doing anything extraordinary, we lean on that side or tolerate that side. If we're not so tolerant of that, we will be a little more aggressive in making sure that borrowings don't get too much above where we're talking about. It's very hard to judge that mechanically, because it depends upon what the market is thinking --how high the market shoves the federal funds rate. Therefore, we can get some surprisingly high borrowing in the beginning of the period, and there's not much we can do about it, once it is borrowed, without really putting out the money later in the week.

MR. MARTIN. Especially when we don't seem to understand why it is that there's this demand, particularly in the smaller institutions, for excess reserves.

CHAIRMAN VOLCKER. What you can do, if that's the judgment--you can't provide any insurance but if you want to lean against getting those kinds of borrowing figures--is put the money in a little earlier than you otherwise would put it in.

VICE CHAIRMAN CORRIGAN. Well, the market also runs ahead of itself. If you look at this whole period since the last Committee meeting, some of the increase in the funds rate, and I think some of the marginal pressure on the borrowings, just reflected the change in market psychology that took place early on in the period. There's no

way in the world that you can try and wash that out. The market seems to do a pretty good job these days of getting ahead of this thing.

CHAIRMAN VOLCKER. From my standpoint, a not unreasonable approach would be to say that we're aiming at something like \$350 to \$400 million. That doesn't guarantee that in particular weeks or two-week periods it wouldn't be above that in particular circumstances; but we aim in that area with a little more caution or aggressiveness--depending upon which side you look at it--than we did last interval. That is lower than some people preferred, but there was a substantial body of opinion in that area. I think this would be consistent with the funds rate not going above 9 percent, but I don't know. Nobody knows. I've asked people what they want. We have a suggestion from Governor Partee to narrow that [funds rate] band. Does that attract support?

MR. WALLICH. I think if we lower that, that would signal to the market that we've shifted to a different kind of approach. In principle, I would like an early consultation; I think that makes a lot of sense--but not if we tell them we have narrowed the band and we are focused more on the funds rate.

VICE CHAIRMAN CORRIGAN. Yes, I could associate with that view. I think there may well be a case here for some bias in the direction of early consultation. But I would not want to see the formal band in the directive changed.

MR. MARTIN. I think it will be interpreted as: "There they go, targeting interest rates." I would join my two colleagues, or three colleagues, in opposing that.

MR. PARTEE. There has been a lot of talk about targeting interest rates as we've gone around the table.

MR. RICE. No. Speakers mentioned interest rates but nobody has been talking targeting; they are talking about what they would like to see.

CHAIRMAN VOLCKER. Want to argue further Governor Partee?

MR. PARTEE. No. I think it's out of character for me to even propose it!

CHAIRMAN VOLCKER. Well, let's assume that the funds rate band stays. But the message is that if the rate got above 9 percent, some people might be concerned enough to want to have a discussion of that. I think that message is clear. There aren't any other variables. The question is this borrowing number, if the 6, 7, 8 percent formulation is generally acceptable. Should I propose \$350 to \$400 million?

MR. MARTIN. Yes sir.

MR. GUFFEY. If we're successful in hitting \$350 to \$400 million, that will be the first time the market would have seen that number for about three or four weeks. I don't know what the reaction would be, but it could be one of ease, if we did it more than one week.

CHAIRMAN VOLCKER. Yes, we might be into very [sensitive]--

MR. RICE. The market might like that.

MR. GRAMLEY. If I thought that were going to happen, I would share Roger's concern. I would rather have the market say: "There has been no change in policy and the Fed is even-keeling now; it hasn't panicked because of those high growth numbers for money early in the year; on the other hand, it is not prepared to lower interest rates because it appears that the economy is going into recession." So, if Roger is right, I'd rather see \$450 million. I'm not sure.

MR. PARTEE. Well, the market looks at excess reserves too. And if the borrowing fluctuates some while excess fluctuates too, it seems to me they can put it together.

CHAIRMAN VOLCKER. Whatever number we put down here, I think one can be pretty sure that if excess reserves really jumped in some week, the way it would work out is that the borrowings probably would jump too. But we would be more cautious of them, probably, than we have been. There's a little peculiarity in the record: The last time we said [in the directive] that we didn't change, and we didn't have much change. If you just looked at borrowings, it looks like we tightened up. If we say we're [not] going to change this time and they go down, it looks like the opposite.

MR. AXILROD. Borrowings thus far this week, the week that we're going to publish--the week, not the two weeks--in the most recent Fed statements is running very close to \$400 million, for whatever [that's worth].

VICE CHAIRMAN CORRIGAN. Taking account of all the noise, particularly that one two-week period where we had that \$1-1/2 billion borrowing [by one] institution, I don't think the markets would sense that we're very far away from \$400 million right now would they, Peter?

MR. STERNLIGHT. They probably would guess that we had aimed at something like \$400 to \$500 million, because I think they dismissed that \$600 million plus that we had in one two-week period. They probably would be thinking \$400 to \$500 million.

MR. BLACK. Well, shouldn't we then consider using that figure?

MR. RICE. \$350 million. That's what we [unintelligible] because we might get something on average a lot higher, just like now. \$350 million.

MR. GRAMLEY. I think if we start with borrowing of \$350 to \$500 million, that ought to provide a lot of flexibility on exactly how that's interpreted, depending on demand for excess reserves and so on. And that's certainly not too wide a range of borrowing to be unreasonable.

CHAIRMAN VOLCKER. What did you say--\$350 to \$500 million?

MR. GRAMLEY. \$350 to \$500 million.

CHAIRMAN VOLCKER. I said \$400 million.

MR. GRAMLEY. Yes, I know. But I'm responding to Bob Black's suggestion that maybe we ought to start with \$400 to \$500 million instead of \$350 to \$400 million because that's really where we are now according to Peter Sternlight. So, I say let's be very reasonable: let's start with \$350 to \$500 million as a working range; that's presumably one we all might be able to live with.

MR. KEEHN. I would think the \$350 to \$500 million would be a good compromise for the difference.

MR. GUFFEY. I assume the path then would be built upon a \$425 million level.

MR. AXILROD. Well, Governor Gramley, that is where we are in terms of borrowing; it's not where we are now in terms of implied free reserves. I'm not arguing for a free reserves target. All I'm saying is that it is a shade tighter than we've been aiming to be, because on free reserves in the same way, it will be a shade tighter.

MR. MARTIN. And 6-1/2 percent to 6 percent [on the M1 objective] is a shade tighter.

MR. AXILROD. Oh, yes.

MR. MARTIN. Okay, now we have two shades.

MR. PARTEE. I prefer \$350 to \$400 million, with some flexibility in--

MR. RICE. I support that too.

MR. MARTIN. I would too.

VICE CHAIRMAN CORRIGAN. I can associate with that too.

MR. KEEHN. Isn't \$350 to \$400 million a very narrow range? Really?

MR. GRAMLEY. It means we're going to start at \$375 million.

MR. PARTEE. Well, we ordinarily use a single point.

VICE CHAIRMAN CORRIGAN. We usually have one single point.

CHAIRMAN VOLCKER. Well, sometimes we have one number and sometimes we have a range. In any case, it's implied as we play this out during the period, depending upon how money and other numbers run, that we take the risks of it being higher or lower. Well, I don't know where we are on this. We have a fair number of people around \$350 to \$400 million; we have a fair number who have something like-- I'm checking off numbers here. Mr. Balles and Mr. Forrestal have not expressed themselves recently.

MR. FORRESTAL. I said \$400 to \$500 million, I thought..

CHAIRMAN VOLCKER. I know; I thought maybe you'd become more flexible.

MR. FORRESTAL. I'm not much concerned about the difference between \$350 and \$400 million. I am more flexible in that respect.

MR. BALLE. I supported "B" as stated, Mr. Chairman.

CHAIRMAN VOLCKER. That's \$350 million.

MR. PARTEE. Average the two of them.

MR. MARTIN. The great compromiser!

CHAIRMAN VOLCKER. And Mr. Rice is there too.

MR. RICE. \$350 million.

MR. PARTEE. Martha was there too.

MS. SEGER. Right.

MR. BLACK. Mr. Chairman, could I ask Steve to elaborate a little more on what he thinks the federal funds implication of that might be?

MR. AXILROD. Of what?

CHAIRMAN VOLCKER. In that case, we're not worried about the federal funds rate.

MR. BLACK. Yes, but--

MR. STERNLIGHT. If we really were to achieve \$350 million, I think the implication for the funds rate would be something a little under 8-1/2 percent, maybe 8-1/4 percent. It really depends partly on what we put in for excess reserves too, Mr. Black. I think if we were to stay with \$600 million, which has been proving to be on the low side, then using \$600 million for excess and \$350 for borrowing is really like imposing a somewhat higher level of borrowing--the \$350 million would be more like getting \$450 million. And with that, I think you'd get maybe 8-1/2 percent on fed funds. My own feeling is that if you're going to have some flexibility on the borrowing, you have to have some on the excess too, which we have to a degree.

MR. RICE. We should know whether we can get fed funds rates running for a few days at 8-3/4 percent while remaining at \$350 million.

VICE CHAIRMAN CORRIGAN. [Unintelligible] percent.

CHAIRMAN VOLCKER. Well, we ought to talk about the wording, which I suppose is related. Most people are reasonably satisfied with \$350 to \$400 million. I think it reduces itself to a simple question: Does it help in terms of happy harmony, in people's best opinions, to make it \$350 to \$450 million?

MR. GUFFEY. [Unintelligible.]

MR. KEEHN. Yes.

MR. BLACK. Yes.

CHAIRMAN VOLCKER. What about those on the other side?

MR. MARTIN. Yes.

CHAIRMAN VOLCKER. All right, why don't we say \$350 to \$450 million? [Whether we] remain within that range in one particular week or two-week period will be gauged in part on how the money supply and other things [behave]--money supply and the exchange rate being the most obvious short-term indicators. All right, it's 6, 7, and 8 percent, \$350 to \$450 million, depending upon money growth and the exchange rate.

MR. GRAMLEY. And the economy also.

CHAIRMAN VOLCKER. Well, the economy too; but it's not likely to change enough to remake the economy.

MR. BLACK. Mr. Chairman, what about the "woulds" and "mights"?

CHAIRMAN VOLCKER. I'll get to the wording now. This [draft] has so many words crossed out and put in that I find it a little difficult to read. The first sentence is fairly straightforward: "In the implementation of policy for the immediate future, taking account of the progress against inflation, uncertainties in the business outlook, and the exchange value of the dollar, the Committee seeks to maintain the existing degree of pressure on reserve positions." Then it goes on: "This action is expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively during the period from March to June." Now we have the "woulds" and "mights" in this next sentence. Before I get to that, in that next sentence, which begins "In either case, such a change," I'm not sure I like all those things here, but I think we ought to mention all of them somehow. We have a 6 to 10 percent funds range with the understanding of Mr. Partee's concern. I might say, based upon what I know now, that I'm a little more reluctant to tighten than to ease. I can imagine conditions in which one might want to tighten; I can more easily imagine conditions in which one would want to ease.

MR. PARTEE. It seems to me that we ought to be symmetric, Paul, and that we ought to use the word "might" in both cases instead of "would."

MS. SEGER. And put the ease first.

CHAIRMAN VOLCKER. I guess at least we could do that--put ease first and use "might" in both sentences. That's not too bad.

MR. GRAMLEY. On page 13, this sentence that begins: "In either case, such a change would be considered only in the context" why do we want the word "only"? We should just flat put it that we would consider this in the context of some larger considerations.

CHAIRMAN VOLCKER. If we put "might" in both cases, that's even more clear.

MR. PARTEE. I think that's right.

CHAIRMAN VOLCKER. We'll do that, if that's acceptable, and reverse the sequence. We use "might" in both cases and take out the word "only." Is that all understood?

MR. PARTEE. And the funds rate 6 to 10 percent?

CHAIRMAN VOLCKER. The funds rate range is 6 to 10 percent and it's 6, 7, and 8 percent [for the aggregates]. It all reads as it is except we reverse the order of the sentence, use the word "might" and take out "only." All the rest is the same.

MR. AXILROD. That's right. You have left in the phrase in brackets that's in the first sentence?

CHAIRMAN VOLCKER. Yes. I think it's useful. I don't know that anybody else has an opinion. Okay.

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Corrigan	Yes
President Balles	Yes
President Black	Yes
President Forrestal	Yes
Governor Gramley	Yes
President Keehn	Yes
Governor Martin	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Wallich	Yes

CHAIRMAN VOLCKER. I guess we're finished.

END OF MEETING